

Department of the Treasury

Internal Revenue Service  
Western Key District (EP/EO)

2 Cupania Circle  
Monterey Park, CA 91755  
Attn:EP/EO:Rev:WLS

Date: NOV 29 1999

Employer Identification Number:  
[REDACTED]

Case Number:  
[REDACTED]

Person to Contact:  
[REDACTED]

Special Identification Number:  
[REDACTED]

Telephone Number:  
[REDACTED]

CERTIFIED MAIL

Dear Applicant:

We have considered your application for exemption from Federal income tax as an organization described in section 501(c)(3) of the Internal Revenue Code.

The information submitted discloses that you were incorporated in the State of [REDACTED] on [REDACTED]. The specific purpose of your organization per your Articles of Incorporation reads in part as follows: "... to promote and encourage interest in the arts among its members and the community; and to manage and conduct activities to further said purpose".

You requested non private foundation status as an organization described in sections 509(a)(1) and 170(b)(1)(A)(ii) of the Internal Revenue Code, as a school.

The activities of your organization according to your Form 1023 are for the Artists to show and sell their works, art classes, exhibiting new artists' works and exhibiting school children's' art works. Also, each dues paying member is part owner of the art gallery.

FACTS:

The activities of your organization allow members to show and sell their works. Each member pays a monthly membership dues of \$[REDACTED] that allows him/her to have their work approved by the other members to sell at the gallery. Also, each member becomes part owner of the art gallery (like a co-operative) which requires him/her to sit and keep the gallery open, answer questions from the general public, and clean and hang pictures. Art classes are conducted by interested members who pay a set fee to the organization.

[REDACTED]

Your income is from monthly dues, art sales, class fees, and miscellaneous sales. Expenditures are for rent, insurance, telephone, utilities, repairs, advertising, taxes, art sales commissions, and miscellaneous.

You stated that the art gallery is open everyday from 10:00am to 7:00pm with free admission. The members control all of the activities. The officers are not compensated nor are any paid employees hired.

The Schedule B of Form 1023 submitted shows that you have no regularly scheduled curriculum, no regular faculty, and no regularly enrolled student body.

ISSUE:

Does the organization qualify for exemption as an organization described in section 501(c)(3) of the Internal Revenue Code?

Does the organization qualify as a school as described in section 170(b)(1)(a)(ii) of the Code?

LAW:

Section 501(c)(3) of the Internal Revenue Code describes certain organizations exempt from income tax under section 501(a) and reads in part as follows:

"(3) Corporations, and any community chest, fund, or foundation organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on legislation, (except as otherwise provided in subsection (h)), and which does not participate in, or intervene in (including the publishing or distribution of statement), any political campaign on behalf of any candidate for public office."

Section 513 of the Internal Revenue Code defines a trade or business as "...any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501..."

A "trade or business" is defined in Section 1.513-1(b) of the Income Tax Regulations as having the same meaning it has for purposes of section 162, and "generally includes any activity carried on for the production of income from the sale of goods or performance of services."

In Presbyterian & Reformed Publishing Co. v. C.I.R., 79 T.C. 1070 (1982), the Tax Court found that the manner in which the organization conducted its activities revealed a nonexempt commercial purpose that was substantial in nature. In making this determination, the court noted that whether an organization satisfies the operational test is essentially a question of fact. The court noted that where a nonexempt purpose is not an expressed goal of the organization, courts have nonetheless focussed on the manner in which the organization conducts its activities, implicitly reasoning that an end can be inferred from the means chosen to attain it. If, for example, an organization's management decision replicate those of commercial enterprises, it is fair to infer that at least one purpose of the organization is commercial.

The Supreme Court stated in Better Business Bureau v. United States, 326 U.S. 279, 66 S. CT. 112, 90 L. ED. 67 "...the presence of a single [non charitable] purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly (charitable) purposes."

See Church of Boston V. Commissioner, (1978) 71 T.C. 102; Colorado State Chiropractic Society, (1989) 93 T.C. 487; Best Lock Corporation, (1959) 31 T.C. 1217; St. Louis Science Fiction Limited v. Commissioner, T.C. Memo 1985-162 and Minnesota Kingsmen Chess Association Inc. v. Commissioner, T.C. Memo 1983-495; all of these court cases held that the presence of a single non-exempt purpose and a substantial non-501(c)(3) activity results in loss of exemption despite the presence of other exempt purposes.

Revenue Ruling 71-395, 1971-2 CB 228, states that a cooperative art gallery formed and operated by a group of artists for the purpose of exhibiting and selling their works does not qualify for exemption under section 501(c)(3) of the Code.

Revenue Ruling 76-152, 1976-1 CB 151, states that a nonprofit organization formed by art patrons to promote community understanding of modern art trends by selecting for exhibiting and selling art works of local artists, retaining a commission on sales less than customary charges and not sufficient to cover the cost of operating the gallery, does not qualify for exemption under section 501(c)(3) of the Code.

#### ANALYSIS:

All of the preceding Code sections, Regulation sections, Revenue Rulings and court cases describe the criteria under which an organization may be exempt under section 501(c)(3) of the Internal Revenue Code. They also describe the basis for which organizations were denied exemption because they were not organized and operated exclusively for section 501(c)(3) purposes, but for the private benefit of their members. Also, it appears that your organization is operating as a trade or business selling art works on a regular basis.

Under section 501(c)(3) of the Code, organizations who are not operated exclusively for one of the specified purposes of section 501(c)(3) or organizations whose sole purpose is providing private benefit to its members or individuals is not exempt under section 501(c)(3) of the Code. Your organization's activities consist primarily of operating a trade or business for the private benefit of your members. Your members approve each new member by accepting his/her art works. As long as each member pays the monthly due of \$[REDACTED], he is a shareholder (part owner) of the art gallery. When each art work is sold, the organization retains [REDACTED]% of the sales. Each artist is paid [REDACTED]% of the sales. This appears to be a private interest and more than just an incidental activity.

Those individuals who teach classes, at their convenience, pay a set fee to the organization, and keep the fees that he/she charges for the classes. The organization did not meet the requirements as described under section 170(b)(1)(A)(ii). Your Schedule B of Form 1023 indicated that you have no regularly scheduled classes, no regular faculty, and no regularly enrolled student body.

In order to qualify for non private foundation status under sections 509(a)(1) and 170(b)(1)(A)(ii), the organization must first be exempt under section 501(c)(3). You did not satisfy the Service that you meet any of the exempt purposes as described under section 501(c)(3) of the Code.

CONCLUSION:

To be considered for tax exempt status under section 501(c)(3), an organization must be both organized and operated exclusively for one or more of the purposes specified in that section. Also, its activities must be restricted to those permitted a section 501(c)(3) organization.

It is the position of the Internal Revenue Service, based on the information submitted, that you are not entitled to exemption from Federal income tax as an organization described in section 501(c)(3) of the Internal Revenue Code, inasmuch, as you are not organized and operated exclusively for any of the specified purposes within that section. Further, you do not meet the requirements of a school as described in section 170(b)(1)(A)(ii). You are both organized and operated exclusively for the private benefit of your members.

If you are in agreement with this proposed determination, we request that you sign and return the enclosed agreement Form 6018. Please note the instructions for signing on the reverse side of the form.

If you disagree with this proposed determination, we recommend that you request a hearing with our office of Regional Director of Appeals. Your request for a hearing should include a written appeal giving the facts, law, and any other information to support your position, as explained in the enclosed Publication 892. You will then be contacted to arrange a date for a hearing. The hearing may be held at the office of Regional Director of Appeals or, if you request, at a mutually convenient District Office. A self-addressed envelope is enclosed.

If we do not hear from you within 30 days from the date of this letter, and you do not protest this proposed determination in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies and will then become our final determination.

Section 7428(b)(2) of the Internal Revenue Code provides in part that "declaratory judgement of decree under this section shall not be issued in any proceeding unless the Tax Court, the Claims Court, or the district court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service."

Form **6018**  
(Rev. August 1983)

Department of the Treasury-Internal Revenue Service  
**Consent to Proposed Adverse Action**  
(All references are to the Internal Revenue Code)

Prepare In  
Duplicate

Case Number

[REDACTED]

DLN [REDACTED]

Date of Latest Determination Letter

Employer Identification Number

[REDACTED]

Date of Proposed Adverse Action Letter

Name and Address of Organization

[REDACTED]

I consent to the proposed adverse action relative to the above organization as shown by the box(es) checked below. I understand that if Section 7428, Declaratory Judgments Relating to Status and Classification of Organizations under Section 501(c)(3), etc. applies, I have the right to protest the proposed adverse action.

**NATURE OF ADVERSE ACTION**

☒ Denial of exemption

☐ Revocation of exemption, effective

☐ Modification of exempt status from section 501(c)( ) to 501(c)( ), effective

☐ Classification as a private foundation (section 509(a)), effective

☐ Classification as a non-operating foundation (section 4942(j)(3)), effective

☐ Classification as an organization described in section 509(a)( ), effective

☐ Classification as an organization described in section 170(b)(1)(A)( ), effective

If you agree to the adverse action shown above, please sign and return this consent. You should keep a copy for your records.

If you sign this consent before you have exhausted your administrative appeal rights, you may lose your rights to a declaratory judgment under section 7428.

(Signature instructions are on the back of this form.)

Name of Organization

[REDACTED]

Signature and Title

Date

Signature and Title

Date